Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Federal-State Joint Board on	)	CC Docket No. 96-45
Universal Service	)	
	)	

Comments of Harris, Skrivan & Associates, LLC
Regarding the Federal-State Joint Board Recommended Decision
Adopted November 7, 1996

Harris, Skrivan & Associates, LLC (HSA) is a financial and regulatory consulting firm providing services to Independent Local Exchange Carriers throughout the United States. These comments represent HSA's Independent Telephone Company clients, including Cross Telephone Company, Pottawatomie Telephone Company, Cimarron Telephone Company, Carnegie Telephone Company, Smithville Telephone Company, Valley Telephone Cooperative, Copper Valley Telephone Company and Home Telephone Company.

Executive Summary

The application of proxy models to rural telephone companies will be very difficult to achieve and may produce inconsistent and unsuitable results. The Federal Communications Commission (FCC) should offer an option to companies to choose proxies or to stay on embedded costs. If proxy models are to be available to rural telephone companies, the development of such models needs to be more friendly to small company participation.

The calculation of Long Term Support (LTS) amounts for individual companies can be streamlined by establishing LTS at each company's net NECA Common Line Settlement amount. Even so, a problem will persist in calculating the amount of Common Line associated with frozen LTS amounts in future years.

The Joint Board's recommendation that Universal Service Funding (USF) should not apply to second residential lines, second homes and multi-line businesses cannot be reconciled with the Communication Act's requirement, in Section 254(b), *Consumers in all regions of the Nation, including low-income consumers and those in rural, insular, and high cost areas, should have access to telecommunications and information services, including interexchange services and advanced telecommunications services, that are reasonably comparable to those services provided in urban areas and that are available at rates that are reasonably comparable to rates charged for similar services in urban areas."*

There may be rural service areas in the contiguous United States which have conditions which justify a departure from the Joint Board's recommendations on movement to proxy USF funding. The Joint Board recognized such a situation in the insular areas of Alaska, Hawaii, Guam and the Virgin Islands. The FCC should establish a methodology for rural telephone companies to be exempted from the requirement to move to proxies.

Frozen USF support to incumbent rural telephone companies should not be made portable to competitive wireline or wireless carriers. The costs of an incumbent exchange carrier will not be reduced even when significant numbers of customers are lost to competition. The incumbent cannot simply roll up its buried cable and redeploy it to another more lucrative market.

Application of Proxies to Rural Telephone Companies

HSA and its clients appreciate the Joint Board's recognition that the application of proxies to small rural telephone companies is very different than to large urban companies. As we stated in our original comments in this proceeding,[1] there are five main reasons why it is more expensive to serve rural areas than urban areas.

First, rural areas are generally located a distance away from a major city or town. This requires longer than average transport to carry less than average traffic.

Second, rural areas have lower subscriber density than is found in urban areas. This results in smaller cables being run longer distances with a lower cable fill factor.

Third, the switching equipment in rural areas serves much smaller concentrations of customers.

Fourth, the administration of a small rural telephone company takes a certain minimum amount of work, regardless of how many or how few subscribers are served.

Fifth, while rural companies may not achieve the economies of scale achieved by large urban companies, the level of service provided by rural telephone companies is generally higher than what is offered in urban areas, especially for residential customers.

In addition to costs being higher in rural areas, costs are also less predictable in rural areas. First, the smaller number of exchanges does not allow for averaging of results to smooth out unusual geographic features. Second, rural telephone companies serve areas that were not attractive to the Bell Companies early in the century. This may have been due to low population or for economic reasons such as terrain or remoteness.

For all these reasons, it will be extremely difficult to design a generic proxy model which will accurately depict the costs of the rural telephone companies in all their diverse situations. It seems unlikely that the Industry will design a proxy model for large companies that will be appropriate to small companies after the initial three year transition. It seems equally unlikely that a proxy could be designed for rural companies that meets the needs of even a majority of the companies.

[1] Comments of Harris, Skrivan & Associates, LLC at Page 7.

Therefore, HSA and its clients recommend that the Commission provide a cost based alternative to the Independent Telephone Companies. This alternative may either be the existing USF, Weighted Dial Equipment Minutes (Weighted DEM) and LTS mechanisms, or it may provide some variation and/or consolidation of the formulas. In addition, we recommend the Commission allow rural telephone companies to opt into use of the proxy model at any time, as was recommended by the Joint Board.

Further Development of Proxy Models

HSA and its clients have several concerns regarding the proxy models under development by the Industry. First, small companies have had difficulty participating in the process. The proxy models have been difficult and expensive to obtain, and the computers required to run the models require extensive memory capacity. In addition, the process of proxy development has been undertaken by large operating companies which have devoted substantial employee time and money to the effort. Small companies have not had the resources to deal with this process. While small companies may not have the resources to develop proxy models of their own, they may have a better knowledge of their facility costs and can therefore make valuable contributions to the process. We recommend that if the FCC intends for proxy models to apply to small companies, the models should be made more available to small company representatives, small company participation should be actively recruited to participate in the model development and free training be provided while the models are still being developed.

Our second concern regarding proxy models is the nature of the models themselves. The models are built on every best-case scenario known to mankind, in an effort to reduce USF funding levels and create opportunities for competitive LECs. The models assume no embedded or sunk costs, and use of the latest forward-looking technology, with minimal requirements for maintenance spares and no requirements for growth. In addition, the calculations for key variables, such as subscriber density, assume the incumbent LEC will be the only service provider, while the entire Industry is gearing up for competition. In some cases, the latest forward-looking technology may not be

available to incumbent telephone companies. For example, if wireless technology is the best solution, an incumbent may not have the authority to use such technology.

Calculation of LTS Amounts - There is an Easier Way

The Joint Board recommends that the LTS amounts be allocated to LTS beneficiaries on the basis of the ratio of the each company's Common Line revenue requirement to the total NECA pool Common Line Revenue Requirement.[2] However, there is a much easier way to allocate LTS among the recipients.

Under current Part 69 rules,[3] LTS is residually derived by starting with the NECA Common Line Revenue Requirement, and subtracting expected revenues from End User Subscriber Line Charges and Carrier Common Line Charges.[4] End User Subscriber Line Charges are capped at $3.50 and $6.00, so the revenue can be easily determined.[5] The Carrier Common Line Charge is based on the average Carrier Common Line Charge of the Price Cap Carriers,[6] so the revenue from this source can also be easily determined.

Therefore, there is a much simpler and more useful way to calculate individual LTS support for each individual company. The LTS benefit to the NECA Common Line Pool is the difference between its Common Line Revenue Requirement and its billed revenue from End User Common Line Charges and Carrier Common Line Charges. Therefore, the LTS benefit to each company is the difference between each company's Common Line Revenue Requirement and its billed revenue from End User Common Line Charges and Carrier Common Line Charges. This also happens to be each company's annual Common Line net settlement. Therefore, the simplest way to calculate an individual company's frozen LTS support would be to use its annual net settlement with the NECA Common Line Pool (removing out-of-period adjustments).

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[2] See Paragraph 293 of the Joint Board Recommendation.

[3] See Paragraph 69.612(a) of the FCC Rules.

[4] Technically, it is slightly more complex than this. Under Part 69 rules, there are actually two Common Line Pools; one is for End User Common Line and the other for Common Line net of End User Charges. The Common Line Pool is the residual after End User revenues are calculated. However, for all intents and purposes, the two pools function as one pool.

[5] See Paragraphs 69.104 and 69.203 of the FCC Rules.

There are several advantages of setting each company's LTS settlement amount at its net Common Line settlement from NECA. First, the calculation of the settlement amount is simplified. Second, an incentive option becomes immediately available to current NECA pool members. Members could be given the option of exiting the pool, maintaining their existing End User Subscriber Line Charge and Carrier Common Line Charge rates. This would provide incentives to electing carriers to control Common Line costs and work to stimulate demand. It would benefit end users and carriers by effectively capping the End User Subscriber Line Charge and the Carrier Common Line Charge.

To the extent there are any net contributors to the NECA Common Line Pool, apart from the LTS contributors, the above plan may need to be modified slightly.

Regardless of how LTS support is calculated for each current member of the NECA Common Line Pool, there is still a problem associated with how Common Line Revenue Requirements and Pooling would be administered. The other two portions of the new USF do not present such a problem. For example, existing USF, under the Joint Board Recommendation, is simply frozen. And, weighted DEM in excess of 1.0 is simply frozen while the new unweighted DEM is calculated on an annual basis, as it is today, but without weighting.

However, no such simple solution is available for the new calculation of Common Line Revenue Requirements, net of frozen LTS support. There is not any way to segregate the frozen revenue requirement from the remaining revenue requirement. For example, assume Company A has a Common Line revenue requirement of $400,000 and $150,000 is established as the frozen LTS portion. In the following year, the Common Line Revenue Requirement increases to $420,000. How much of the $420,000 is subject to NECA Pooling and settlements? This problem needs to be addressed in this proceeding!

[6] See Paragraph 69.105(b)(2).

Application of Frozen Support Funds

The Joint Board recommended that USF be frozen on a per line basis and paid to Incumbents based on the number of first residential lines, excluding second homes, and single line businesses. This excludes support for second residential lines, vacation homes and multi-line businesses. The major problem with this plan is that it would require high cost rural telephone companies to either lose money by selling service for less than their costs, or significantly increase line charges to second residential lines, vacation homes and multi-line businesses.

The level of such increases could very well result in increases that violate Section 254 of the Telecommunications Act of 1996. Section 254(b)(3) of the Communications Act, as revised, reads, *"(3) Access in rural and high cost areas – Consumers in all regions of the Nation, including low-income consumers and those in rural, insular, and high cost areas, should have access to telecommunications and information services, including interexchange services and advanced telecommunications services, that are reasonably comparable to those services provided in urban areas and that are available at rates that are reasonably comparable to rates charged for similar services in urban areas."* Nothing in this sections indicates the FCC is free to establish rules which exclude second residential lines, second homes and multi-line businesses from the requirements of Section 254(b)(2). Therefore, the FCC should include USF payments to rural companies for all access lines served.

If the Recommendation is implemented as suggested, small companies will be forced to send market messages that will sharply curtail small business development and residential access to advanced online services. This is clearly in contrast to the principles of the 1996 Act.

Frozen Universal Service Should not be Portable

The Joint Board recommended that Universal Service Funding to rural telephone companies be made portable. This would allow the per-line funding to accrue to existing cellular companies, as well as new PCS and competitive wireline LECs.

There are many reasons why rural telephone companies are today receiving Universal Service Funding, Weighted DEM and LTS support. However, the sole basis for such support payments is the actual costs to provide the service by each rural telephone company. If customers of rural LECs are lost to wireline or wireless competitors, the costs of the incumbent LEC are not likely to decrease. In fact, even if the company continues to receive the full amount of frozen USF, it would be in a worse financial position since the loss of local and access revenues associated with lost customers will far exceed any cost reductions.

As stated above, it is unlikely that rural telephone companies will see reduced costs if customers are lost to competitive local service providers. This is because most of the costs of the rural LECs are based on investment in buried cable and central office switches. And, even if a rural telephone provider were to lose a significant portion of its customer base to competition, it would continue to depreciate and maintain its existing cable plan and central office switches.

Treatment of Rural Service Areas as "Insular"

The Joint Board has recommended the "insular" areas of Alaska, Guam, Hawaii and the Virgin Islands be allowed to continue to receive Universal Service Funding based on embedded costs, under the belief that proxy models will not address their unique conditions. HSA believes there are areas of the contiguous United States which may have similar characteristics to Alaska, Guam, Hawaii and the Virgin Islands with respect to costs supported by Universal Service mechanisms. HSA and its clients request that the FCC establish criteria which would allow rural telephone companies to be designated as serving "insular" areas. Such criteria could be established in the FCC's Order in this proceeding, or the FCC could explicitly provide for exemption filings for companies to continue to receive Universal Service Funding based on embedded costs. Such exemptions could be based on geographic factors which make it difficult and costly to provide telecommunications service.

In terms of the recommended functioning of the new Universal Service Fund, some rural companies may actually be in greater need of funding based on embedded costs than the identified insular areas of Alaska, Hawaii, Guam and the Virgin Islands. The new Universal Service Fund has two mechanisms (current USF and Long Term Support [LTS]) which support local loop costs. The third mechanism supports high local switching costs (Weighted DEM). However, the high costs associated with the identified insular areas are not only related to high loop and switching costs, but are heavily related to exceedingly long ***interexchange transport requirements***. Therefore, since specific acknowledgment is made of such companies even when the proposed new USF mechanisms do not address the interexchange transport costs in any way, it would be appropriate for similar treatment to be extended to other companies which have similar cost drivers for provision loop and switching functions.

One characteristic of the defined insular areas is that the population tends to be clumped in closely packed communities. This characteristic actually minimizes loop and switching costs. However, in the areas served by many rural telephone companies, the

population is may be more spread out than in the defined insular areas. Thus, some rural company's loop costs may be naturally higher than those experienced by the companies serving the defined insular areas.

Respectfully Submitted,

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CERTIFICATE OF SERVICE

I, Michael, T. Skrivan, hereby certify that I have on this 16th day of December, 1996, sent via U.S. First Class Mail, postage prepaid, a copy of the foregoing Comments of Silver Star Telephone Company, in the Matter of Regarding the Federal-State Joint Board Recommended Decision Adopted November 7, 1996, filed this date with the Office of the Secretary, Federal Communications Commission, to the persons on the attached service list

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